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IN THE

Supreme Court of the United States

OCTOBER TERM, 1957.

No. 535

R. J. REYNOLDS TOBACCO COMPANY,

Petitioner,

v.

THE UNITED STATES,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS.

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New York, N. Y.,
October 8, 1957.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS.

TO THE HONORABLE THE CHIEF JUSTICE AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Petitioner, R. J. Reynolds Tobacco Company, respectfully prays the issuance of a writ of certiorari to review the judgment of the United States Court of Claims dismissing a petition for refund of income and excess profits taxes.

Opinion Below.

The opinion of the Court of Claims is reported in 149 F. Supp. 889 (1957). The opinion, together with the findings of fact, is set forth in the Appendix. Motion for rehearing was overruled without opinion.

Jurisdiction.

The judgment of the Court of Claims was entered April 3, 1957 and its order denying rehearing July 12, 1957. The jurisdiction of this Court is invoked under 28 U. S. C. § 1255, subd. 1, 62 Stat. 928.

Questions Presented.

Petitioner (hereinafter called Reynolds) made cash payments to employees under a profit sharing plan for each of the years 1940-1948. The purpose of the plan was to procure better services by encouraging employees to invest in company stock and by providing for annual payments of a share of profits to participating employees. The payments were in proportion to the stock held by employees and were without regard to dividends which were paid to all holders of stock, whether or not employees.

To prove the extent to which the payments were reasonable as compensation, Reynolds introduced in evidence substantial testimony and statistical data. The witnesses were not impeached and the Government introduced no evidence of unreasonableness.

A majority of the court below held that the payments were not compensation for personal services but were "the very essence of dividends" and therefore not deductible in computing taxable net income. The majority held that the payments could not be deducted on the further ground that no payment was proved reasonable in amount. Two judges concurred in substance on the first issue but refrained from passing on the issue of reasonableness.

The questions presented for review are:

1. Were the payments compensation for personal services?

2. Was the evidence sufficient as a matter of law to prove the reasonableness of any of the payments?

Statutes Involved.

The statutes involved are §§22(a), 23(a)(1)(A) and 115(a) of the Internal Revenue Code of 1939, as amended (53 Stat. 9, 12, 46). The text of these statutes is set forth in the Appendix.

Statement of the Case.

Reynolds is a New Jersey corporation with its executive offices and principal plants in Winston-Salem, North Carolina. Its business is the manufacture and sale of tobacco products, for the most part cigarettes.

Reynolds' profit sharing plan was adopted as a bylaw in August 1912. It provided for the annual payment in cash of not more than 10% of profits in excess of those earned in 1910 to employees who had been employed for a full year and had owned common stock for a full year.[1] Payments were in proportion to stock owned by employees and without regard to dividends paid to all the stockholders whether or not employed. Termination of employment ended participation under the plan.

Earlier in 1912, Reynolds' three major competitors, The American Tobacco Company, Liggett & Myers Tobacco Company, and P. Lorillard Company had adopted profit

[1] After 1918 there were two classes of common stock, "A" and "B", which ranked *pari passu* as to all rights and privileges, except that B stock had no vote and ownership thereof did not entitle an employee to participate under the profit sharing plan.

sharing plans providing for payment of 10% of profits in excess of those earned in 1910 to their respective presidents and vice presidents. By contrast, the Reynolds plan spread the payments down the line and measured participation by employee stock ownership. In the years at bar all four companies had profit sharing plans in operation, Reynolds and American without substantial change, and Liggett and Lorillard in modified form.

Over the years Reynolds applied a policy of broad but selective allotment of stock among employees. Since 1920 the allotments were administered by the committee of the Board of Directors which supervised wage and salary adjustments. Reynolds purchased stock and resold it to employees and supervised sales of stock to employees by retired employees and estates of deceased employees. The committee made allotments to individual employees after reviewing recommendations from supervisory personnel.

Some employees bought less than their full allotment of stock and some bought none at all. Some acquired stock other than by allotment, namely, by inheritance, gift or purchase without committee approval. It was the view of the Reynolds management that these imperfections "did not affect the overall sucess of the plan". (Finding 49) In management's judgment 2.2 to 5.6% of the participating employees received excessive payments in relation to their services and the excess amounted to 1.2 to 3.1% of the total compensation of the participating group. (Findings 50-51)

The number of participants during the years at bar ranged from 1,727 to 2,045 out of a total of approximately 12,000 employees. Stock owned by employees varied from about 5 to 6% of the total outstanding common stock. The incidence of stock ownership ranged from 100% of the

employees in the most responsible positions down to a nominal percentage of hourly workers.

The purpose of the Reynolds plan was found by the Court of Claims to be as follows:

> "The bylaw was set up to provide a plan for profit participation as an incentive to employees." (Finding 99)
>
> . . . . . .
>
> "The purpose of the plan was obviously to encourage employees to become owners of a share of the business, and, by reason of such ownership, would have a greater interest in its profitable operations and would give their best efforts to this end. The plan provided that such employee owners would not only share equally with other stockholders in regular dividend distributions, but would receive special profit-sharing distributions from profits which would result from the greater interest of workers." (Opinion, App. 8-9)
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> . . . . . .
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> "Bearing in mind that the bylaw adopted by plaintiff was prior to the enactment of the income tax laws, we cannot say that the plan was not designed to incite greater efforts on the part of its employees because of investment in the company. Further, we cannot say that the plan was designed for tax avoidance." (Opinion, App. 10)

With respect to the effect of the plan the court found: Ownership of stock by employees "was an incentive to efficiency and cost consciousness". (Finding 63) It attracted new employees and reduced employment turnover. (Findings 64-5) Purchasing, sales, manufacturing and management personnel were very efficient. (Finding 63) Reynolds' growth and earnings record were superior to those of its competitors. (Opinion, App. 5; Findings 52-60) "During the many years following the adoption of

bylaw XII, the operation of the plan thereunder materially aided the progress and development of plaintiff." (Finding 62)

No capital was raised by Reynolds as a result of employee purchases since none of the allotted stock was original issue and since Reynolds made no profit on its sales to employees. (Findings 16, 37)

Before 1949, pursuant to an early ruling by the Bureau of Internal Revenue, Reynolds and the Government both treated the payments as dividends for tax purposes. However, on its books and in its annual reports to stockholders and to the Securities and Exchange Commission, Reynolds always deducted the payments as an expense in determining annual net income.

In 1949, after the bylaw was amended in certain particulars not here significant (Findings 71-74), Reynolds applied to the Commissioner of Internal Revenue for a ruling as to whether the payments were compensation or dividends. The Commissioner ruled that the payments were compensation and would be deductible to the extent reasonable. Reynolds has deducted the payments in its tax returns for 1949 and subsequent years. In 1950 it filed the instant claims for refund for all open years, that is, 1940-1948[2]. In 1951 the Commissioner revoked the 1949 ruling and thereafter denied the claims for refund. He has also disallowed the deductions claimed in the returns for 1949 and 1950.

The issue of deductibility for 1949 and 1950 has been tried in the Tax Court of the United States, which held that the payments were compensation and deductible to the extent that the court found them to be reasonable. *R. J.*

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[2] The face amount of the claims sued for, $8,352,851.83, is reduced to about $5,300,000 as a result of adjustments under Section 734 (1939 IRC) and the amounts conceded to be excessive which are tabulated in Finding 50. The total amount of federal income and excess profits taxes paid by Reynolds for the years at bar was $150,164,284.44.

Reynolds Tobacco Co., T. C. Memo 1956-161, 15 T. C. M. 810 (July 6, 1956). The final order has not been entered in that case because the correct base period net income, necessary to the computation of the 1950 excess profits tax, cannot be determined until a decision in the instant case becomes final.

On the issue of reasonableness, in addition to the evidence reflected above (pp. 5-6) showing the effects of the bylaw on employee efficiency and company success, there were stipulated exhibits in evidence showing by employment categories the name, length of service, base pay and bylaw payments of each participating employee for each year. (Exhs. J-22-30). Findings 45 through 48 reflect the patterns of participation both by employment categories and by compensation ranges.

With respect to the officer group Findings 90 and 91 show a comparison of the compensation paid to the officers, both individually and as groups, of Reynolds, American, Liggett and Lorillard. Findings 92 and 93 show the ratios for the respective companies of executive compensation to net sales and earnings before taxes. In addition, the former president of Brown & Williamson Tobacco Corporation testified that the compensation (including bylaw payments) of the Reynolds executive group was reasonable. (Finding 101)

The Findings and Opinion show that the salaries of leaf buyers and salesmen, who worked over wide territories in direct competition with competing buyers and salesmen, were low in comparison to competitors'. The base pay of the other Reynolds employees, virtually all of whom worked in the Winston-Salem area, was at or below the going rates in the community. (Opinion, App. 5-6; Finding 66)

For the nine years at bar there were more than 17,000 payments to employees. Many of the payments were quite

small. For example, the Vice President in charge of sales, whose salary for the years 1945-1948 ranged from $30,000 to $43,500, received annual bylaw payments ranging from $464 to $932. The Solicitor and Assistant to the Chairman of the Board received a salary for the years 1946-1948 of $20,000 to $26,000 and annual bylaw payments from $69.40 to $559.20. For the year 1940, 110 foremen and 318 salesmen each received less than $200 per year, less than $4 per week. For 1948, 106 foremen and 82 salesmen received less than $200 per year. Of the 17,000 payments for the entire period some 6,900 amounted to less than $100 per year, that is, less than $2 per week. (Exhs. J-22-30)

Four executive officers of Reynolds who had reviewed the records of each participating employee testified that with stated exceptions the total compensation, including bylaw payments, of each employee was not in excess of a reasonable allowance for his services. As the court below stated (Finding 101):

> "In making their examinations, the four executives took into consideration the usual factors that enter into an appraisal of the value of an employee's services including his salary and bylaw participation, ability, performance in the job, responsibility, and length of service.".

The court below observed that this testimony was "in no way impeached" and held that it "must be given some weight". (Opinion, App. 13)

In denying the claims for refund the Government made no determination that the payments were unreasonable to any extent. (Opinion, App. 2) It "steadfastly maintained that the payments were preferential dividends." (Opinion, App. 6) It introduced no evidence to refute the testimony as to reasonableness or to prove unreasonable compensation. (Finding 101; Opinion, App. 13, 15)

Basis for Jurisdiction in Court Below.

The suit below arose out of Reynolds' claims for refund of income taxes and excess profits taxes which were disallowed by the Commissioner of Internal Revenue. The suit involves claims against the United States founded upon Acts of Congress and Federal jurisdiction is conferred upon the Court of Claims by 28 U. S. C. §1491, 62 Stat. 940.

Reasons for Granting the Writ.

The decision below that the payments were not compensation is in conflict with the decision of this Court in *Commissioner* v. *LoRue*, 351 U. S. 243 (May 28, 1956).

The decision of the majority that no payment was proved reasonable is wrong as a matter of law. It is predicated on irrelevant considerations, prompted by the error on the first issue, and conflicts with decisions of Courts of Appeal.

Argument.

1. Nature of Payments.

Section 23(a)(1)(A) allows the deduction of business expenses including "compensation" for personal services. Section 22(a) defines gross income as including "compensation" for personal service. The term has the same meaning in both sections.[3] The decision of this Court in *Commissioner* v. *LoRue*, *supra*, on the meaning of compensation under §22(a) is therefore controlling in like cases under §23(a).

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[3] *Joseph W. Frazer*, 4 T. C. 1152, 1155-7 (1945), *Acq.*, *aff'd* 157 F. 2d 282 (C. A. 6th Cir. 1946), *cert. denied* 329 U. S. 807 (1947); *Electric Storage Battery Co.*, 39 B. T. A. 121, 132 (1939), *Acq.*; I. T. 3795, 1946-1 C. B. 15, 16.

The court below found the purpose and effect of the Reynolds plan to be as follows:

> "The bylaw was set up to provide a plan for profit participation as an incentive to employees." (Finding 99)
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> "The purpose of the plan was obviously to encourage employees to become owners of a share of the business, and, by reason of such ownership, would have a greater interest in its profitable operations and would give their best efforts to this end." (Opinion App. 8-9)
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> • • • • • •
>
> "During the many years following the adoption of bylaw XII, the operation of the plan thereunder materially aided the progress and development of plaintiff." (Finding 62)

In *LoBue* the stock option plan "was designed to achieve more profitable operations by providing the employees 'with an incentive to promote the growth of the company by permitting them to participate in its success.'" (351 U. S. at 246) This Court concluded (*id.* at 247):

> "When assets are transferred by an employer to an employee to secure better services they are plainly compensation. • • • LoBue received a very substantial economic and financial benefit from his employer prompted by the employer's desire to get better work from him. This is 'compensation for personal service' within the meaning of § 22(a)."

By contrast the Court of Claims here concluded: "The payments are the very essence of dividends • • •." (Opinion, App. 10)

Although Reynolds in its briefs vigorously relied upon *LoBue* as controlling authority, the Court of Claims did not distinguish, discuss *or even cite it.* Its findings follow

almost verbatim the court commissioner's report filed a few days before this Court's decision in *LoBue*.

The opinion in *LoBue* indicates that the holding was not limited narrowly to stock option cases. Certiorari was granted "to consider whether the Tax Court and the Court of Appeals had given § 22(a) too narrow an interpretation." (351 U. S. at 246) The Court stated that there was nothing in the statute to indicate that "its broad coverage should be narrowed because of an employer's intention to enlist more efficient service from his employees by making them part proprietors of his business." (*Id.* at 247) The Court said, "It makes no difference that the compensation is paid in stock rather than in money." (*Ibid.*) The reasoning and the conclusions are not couched in terms of a reduced purchase price but in the broader terms of benefits conferred in any form upon an employee "prompted by the employer's desire to get better work for him." (*Ibid.*)

Here, as in *LoBue*, the result sought was better employee services. In both cases the method of securing better services was to encourage employees to invest in company stock. In both the benefits were in proportion to the stock purchased. In both the benefits were prompted by the employer-employee relationship and not the company-stockholder relationship. The benefits took a different form in the two cases. In *LoBue* the "carrot before the nose" was a stated price for the stock no matter how great the bargain might become by reason of increase in value of the stock; here the "carrot" took the form of annual cash payments after the stock was purchased, in addition to the dividends paid all stockholders. This difference alters neither the purpose nor the effect of the payments.

No capital was raised by Reynolds as a result of employee purchases. The only consideration for the bylaw payments was services. Accordingly, the payments were

to employees as such and not to "shareholders" within the meaning of § 115(a). The dividends paid to all stockholders constituted the distributions under that section.

The court below held (Opinion, App. 9):

> "In order to construe such distributions as increased compensation for services rendered it must be found that the employee holding the greatest number of shares contributed the most valuable service • • • or that other employees who purchased no shares, contributed nothing to the increased profits from which such dividends were distributable. This has not been proved."

Such requirement of exact equation of benefits received and services rendered is unprecedented and wholly unrealistic. By this standard, benefits conferred under employee stock option and stock purchase plans would rarely if ever be compensation. In all such plans the benefits are precisely related to the stock purchased but the relation to value of services that the Court of Claims would require rarely exists.

LoBue, for example, had three years in which to exercise his options. The amount of the benefit, that is, the spread between the option price and the market value, depended on when he chose to exercise his options and what the market value of the stock happened to be at that time. Often the option period is as much as ten years. In view of the many factors which determine the fluctuating value of stock, a case in which the benefits received match the value of services would be highly fortuitous. In fact, the benefit received by LoBue was substantially greater than his annual fixed salary although, as the Tax Court found, the nature and extent of his duties remained the same throughout his employment. (22 T. C. 440)

It is obvious that where employees are required to invest their own funds in order to procure the benefits of a stock

purchase plan, some will invest the full amount permitted, others only a part, and others nothing. *Ray A. Noland*, 12 T. C. M. 1003 (1953), involved the stock option plan of Trans World Airlines. The Tax Court held that the benefit received by pilot Noland was compensation, observing at page 1004:

> "Some TWA pilots purchased stock under the plan while others did not. The pilots who purchased stock, and others who did not, flew the same flights, did substantially the same amount of work and were paid the same rates of compensation."

The court below would require proof that employees who elected to buy no stock contributed nothing that would have entitled them to benefits under the plan.

The court below has sought to bolster its conclusion by stating that, if there were doubt as to whether the payments were dividends, Reynolds' historical treatment of them "should certainly remove it." (Opinion, App. 10) Suffice it to say that (1) the purpose of the payments made them "plainly compensation" irrespective of historical treatment; (2) the court's own findings show that except for tax purposes the treatment of the payments overwhelmingly indicates that they were compensation; and (3) the treatment for tax purposes was a mistake of law which in no way estops the partial recovery here sought.

The prior tax treatment of the payments resulted from an early ruling by the Bureau of Internal Revenue. (Findings 78, 81) Contrary to the implication in the opinion below (App. 10), such treatment resulted in the payment in every year of more taxes by Reynolds, and by Reynolds and its employees combined, than would have been paid had the payments been treated as compensation. Reynolds began deducting the payments in its tax returns in 1949

when the Bureau ruled that the payments under the bylaw as amended that year were compensation. Two years later, after the instant claims for refund were filed, that ruling was revoked. (Opinion, App. 6-7; Findings 71-4) In the companion *Reynolds* case for 1949 and 1950 the Tax Court stated in regard to the prior tax treatment (15 T. C. M. at 836):

> "But it is fundamental that the petitioner's conception or view of the situation, if it were erroneous at any time in the past, would not preclude it from establishing here the real nature of the distributions for tax purposes."

The case before the Tax Court cannot be distinguished on any tenable ground. There the court followed the *LoBue* principle, citing the decision, and held that the purpose of the payments was determinative of their nature, stating (15 T. C. M. at 836, 838):

> "We think the record sufficiently bears out the contention of petitioner that it was petitioner's intention at the inception of and throughout the operation of the by-law plan to encourage selected employees to invest in the stock of petitioner in order that they might be more closely identified with the company and be spurred to serve the company to a greater capacity. (Such is often the purpose and effect of a stock bonus, stock purchase plan or stock option plan, each of which may likewise be compensatory in nature.)
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> * * * * * *
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> In sum, the payments made to petitioner's employees under a plan, the origin and history of which indicate an attempt to further compensate worthy employees and to thereby secure their continued loyalty and efficient efforts, which plan has been largely successful and has contributed materially to the success of the petitioner, are to be con-

sidered compensatory in nature and deductible to the extent that they are demonstrated to be reasonable in amount."

As matters now stand, there is a direct conflict between the court below and the Tax Court in the case of the same taxpayer. The conflict should be resolved. If *LoBue* is controlling authority, the Tax Court presumably would be sustained on an appeal to the Court of Appeals for the Fourth Circuit. As stated above (p. 7), such an appeal cannot be taken until the decision in this case becomes final. Justice requires that resolution of the conflict not await action by the Court of Appeals, for by then the time for review of the decision below will have expired. The resulting injustice is obvious. See *United States* v. *Ohio Power Co.*, 353 U. S. 98 (1957).

2. Reasonableness of Payments.

Section 23(a)(1)(A) includes among deductible business expenses a "reasonable allowance" for compensation for personal services.

The Commissioner of Internal Revenue has made no determination on the reasonableness issue to which any presumption of correctness might attach. The Court of Claims made no finding that any payment was excessive but reached the sweeping negative conclusion that no payment was proved reasonable. This conclusion is a clear error of law in conflict with decisions of Courts of Appeal.

To summarize: (1) The court did not in fact assume *arguendo*, as stated, that the payments were compensation but persisted in its view that they were at least in part dividends, thus permitting the error on the first issue to vitiate the consideration of reasonableness. (2) The conclusion that no payment was proved reasonable is unten-

able in the face of substantial evidence of reasonableness, including unimpeached testimony, and the failure of the Government to introduce any evidence to prove unreasonable compensation.

At the outset of its discussion of the issue of reasonableness the court stated (Opinion, App. 12):

> "It is impossible, on the record before us, to determine * * * the number of shares of stock that were purchased without company approval and by whom. We cannot make a determination of the amount of refund the plaintiff is entitled to without proof of these facts."

Ultimate Finding 100 is to the same effect and Finding 97 states in the same context that the evidence "does not disclose the weight that should be given to stock holdings as distinguished from pure services". (See also Findings 95, 98.)

The relevant consideration was not the relation of the payments to stock but whether they were excessive in relation to the value of services. The court was preoccupied with, if not controlled by, the stock ownership method of measuring the amount of payments. Such preoccupation was quite inconsistent with the stated assumption (Opinion, App. 12) that the payments were compensation. If the court below had in truth assumed that the payments were compensation, it would have disregarded the manner in which stock was acquired and given no weight to stock holdings. It would have considered reasonableness on the premise that the payments were exactly like any other cash bonus contingent on annual profits.

If the payments are in fact treated as compensation, the unimpeached testimony and other evidence of record require a finding of reasonableness in the absence of any evidence of unreasonableness from the Government. The

decision below conflicts with *Baltimore Dairy Lunch, Inc.*, v. *United States*, 231 F. 2d 870 (C. A. 8th Cir. 1956), *Loesch & Green Const. Co.* v. *Commissioner*, 211 F. 2d 210 (C. A. 6th Cir. 1954), *Indialantic, Inc.*, v. *Commissioner*, 216 F. 2d 203 (C. A. 6th Cir. 1954), *Mayson Mfg. Co.* v. *Commissioner*, 178 F. 2d 115 (C. A. 6th Cir. 1949), *Wright-Bernet, Inc.*, v. *Commissioner*, 172 F. 2d 343 (C. A. 6th Cir. 1949), *R. P. Farnsworth & Co.* v. *Commissioner*, 203 F. 2d 490 (C. A. 5th Cir. 1953), and *J. H. Robinson Truck Lines, Inc.*, v. *Commissioner*, 183 F. 2d 739 (C. A. 5th Cir. 1950).[4] The court below in effect recognized the conflict by its reference to these cases "which seem in point and which caused the court considerable hesitancy". (Opinion, App. 13)

The most recent of these decisions, *Baltimore Dairy Lunch*, is representative. There the Revenue authorities had allowed as reasonable compensation for the taxpayer's treasurer and general manager $7,600 of the claimed $16,621.68. The taxpayer in its suit for refund relied principally on testimony to prove the reasonableness of the full amount claimed. The district court dismissed (121 F. Supp. 357). In reversing, the Court of Appeals for the Eighth Circuit first stated the following general principles regarding review of a lower court's finding (231 F. 2d at 871):

> "The fact that an appellate court might reach a different conclusion on disputed facts is not suffi-

[4] Apparently contrary decisions are distinguishable because they involved opinion testimony which was impeached, inherently improbable, or inconsistent with other substantial evidence. *E.g. Golden Const. Co.* v. *Commissioner*, 228 F. 2d 637, 639 (C. A. 10th Cir. 1955); *R. H. Oswald Co.* v. *Commissioner*, 185 F. 2d 6, 9 (C. A. 7th Cir. 1950), *cert. denied* 340 U. S. 953 (1951). See also *Dayton Power & Light Co.* v. *Commissioner*, 292 U. S. 290 (1934) (leasehold valuations for rate-making purposes), where three opinions of value were rejected because widely divergent, based on the erroneous premise of a free market, and inconsistent with other evidence.

cient reason for reversal. A judgment is clearly erroneous when there is no substantial evidence to support it, when it is against the clear weight of the evidence, or when it is induced by an erroneous view of the law. Pendergrass *v.* New York Life Ins. Co., 8 Cir., 181 F. 2d 136, and cases cited therein. In United States *v.* United States Gypsum Co., 333 U. S. 364, at page 395, 68 S. Ct. 525, at page 542, 92 L. Ed. 746, the finding of the trial court was found to be clearly erroneous, the Supreme Court stating:

> "* * * A finding is "clearly erroneous" when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed.'

See also Universal Camera Corp. *v.* N. L. R. B., 340 U. S. 474, 71 S. Ct. 456, 95 L. Ed. 456."

The Court of Appeals then reviewed the evidence of record, noting in particular that the opinion testimony of Owens, the employee involved, on reasonableness was uncontradicted and that the trial court had not expressed disbelief (*id.* at 874). The court concluded (*id.* at 875):

> "Whether Owens established his right to the full $16,621.68 claimed is a question open to greater difficulty. There is, however, evidence to support such a claim. The taxpayer has by its evidence met the burden of overcoming the presumption of correctness of the Commissioner's finding. The Government has introduced no substantial evidence to show that the salary deduction claimed by taxpayer is unreasonable. Under such circumstances the decision of the trial court is clearly erroneous. R. P. Farnsworth & Co., Inc., *v.* Commissioner, 5 Cir., 203 F. 2d 490; Mayson Mfg. Co. *v.* Commissioner, 6 Cir.,

178 F. 2d 115; J. H. Robinson Truck Lines, Inc., *v.* Commissioner, 5 Cir., 183 F. 2d 739; Wright-Bernet, Inc., *v.* Commissioner, 6 Cir., 172 F. 2d 343. In the Mayson Mfg. Co. case the court quotes with approval from Taylor & Co. *v.* Glenn, D. C. W. D. Ky., 62 F. Supp. 495, 499, the following language, 178 F. 2d at page 121:

> "• • • "If the compensation received • • • was unreasonable for the services rendered, certainly the government could have produced some experienced witness • • • who would have said so. The lack of such evidence operates very strongly against the defendant's contention." ' ' '"

There is extensive testimony in the case at bar supporting the reasonableness of payments to the individual employees. It was based on "the usual factors that enter into an appraisal of the value of an employee's services". (Finding 101) The court stated that the testimony "must be given some weight, especially since the witnesses were in no way impeached". The Government offered no evidence to refute the testimony or to prove unreasonable compensation. The stated reason for the court's not considering the testimony "conclusive" is that "the witnesses, in arriving at their conclusions, did not make an adequate comparison of the wage scales of comparable jobs in other companies of the tobacco industry." (Opinion, App. 13) This reason is untenable both on the law and on the facts.

Comparative evidence, while it may at times be helpful, is not an essential element of proof of reasonableness. In *Mayson Mfg. Co., supra,* the Court of Appeals for the Sixth Circuit reversed the Tax Court on the express ground that "the absence of such [comparative] testimony, from both petitioner and respondent, has little bearing on the issue" (178 F. 2d at 121). To the same effect see *Drilling and*

Service, Inc., 15 T. C. M. 1417, 1424 (1956); *Faucette Co.*, 17 T. C. 187, 196 (1951); and 4 Mertens, Law of Federal Income Taxation, § 25.72, p. 171 (1954). See also *Miller Mfg. Co.* v. *Commissioner*, 149 F. 2d 421, 424 (C. A. 4th Cir. 1945).

To the extent that wage comparisons would be helpful, this record contains evidence on which the court has based express findings. Most of the Reynolds employees worked in the Winston-Salem area where there were no comparable tobacco companies. Hence, comparative wage scales in the industry would have little or no evidentiary value even if they could have been obtained. More significant are the local wage rates and the court has found that the Reynolds wages were at or below the going rate in the community. (Finding 66; Opinion, App. 5) The leaf buyers and salesmen worked over wide territories in direct competition with competitors. As to these the court found that "The fixed salaries paid by plaintiff to its buyers and salesmen were low in comparison to competitors'." (Opinion, App. 5, 6)

With respect to the executive officers the court states that the comparative evidence "related only to the aggregate compensation of the group". (Opinion, App. 14) This is a clear misstatement. Finding 90 sets forth in parallel columns the annual compensation of the "individual officers and directors of plaintiff, American, Liggett and Lorillard".

While conceding the comparative evidence tended to prove that the total compensation of the executive group was not out of line with competitors, the court held it insufficient as to individuals because there was no proof of "comparative duties and responsibilities of the individual officers" of competitors. (Opinion, App. 14) Since comparative evidence is not necessary, *a fortiori* proof of comparative duties and responsibilities is not necessary. *J. H.*

Robinson Truck Lines v. *Commissioner*, 183 F. 2d 739, 740 (1950), *rev'g* 8 T. C. M. 892, 894; *R. P. Farnsworth* v. *Commissioner*, 203 F. 2d 490, 492 (1953), *rev'g* 10 T. C. M. 1181, 1203.

In *Cullers* v. *Commissioner*, 237 F. 2d 611, 616-7 (C. A. 8th Cir. 1956), involving the valuation of real property for gift tax purposes, the Court of Appeals reversed the Tax Court for arbitrarily disregarding competent testimony on grounds which were unsound and for substituting its own judgment which was supported by no substantial evidence. The Tax Court had found a value intermediate between the values claimed by the taxpayer and the Government. In the case at bar the Court of Claims has found that no amount was proved reasonable.

Ultimate Finding 101 contains the startling statement that it cannot be determined from the evidence that the payments were "reasonable as to each and every individual officer and employee for the years 1940 to 1948, inclusive." This appears to mean that the present refund suit is an all or nothing proposition. To the contrary, Reynolds is entitled to recovery to the extent that the evidence proves reasonableness in any individual cases.

Many of the payments were so small that they were patently within the bounds of reasonableness. For example, of the 17,000 individual payments some 6,900 were less than $100 per year. These were not limited to hourly paid workers but included leaf buyers, salesmen, foremen, and others holding supervisory or managerial positions. Many of these payments were less than $50 per year. If any proof be needed to establish the reasonableness of payments such as these, surely evidence which "must be given some weight" suffices.

WHEREFORE, it is prayed that a writ of certiorari issue for review by this Court of the judgment below.

Respectfully submitted,

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